

ST 97-48

Tax Type: SALES TAX

Issue: Responsible Corp. Officer - Failure to File or Pay Tax

STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
SPRINGFIELD, ILLINOIS

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THE DEPARTMENT OF REVENUE	)		
OF THE STATE OF ILLINOIS	)	Docket #	93-ST-0071
	)	IBT #	2160-8695
v.	)	NPL #	XXXX, XXXX
	)		XXXX, XXXX
JOHN & JANE DOE	)		
as responsible officers of	)		
XYZ CORPORATION	)		

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RECOMMENDATION FOR DISPOSITION

Appearances: Charles Hickman, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; David L. Antognoli of Bernard & Davidson for JOHN & JANE DOE.

Synopsis:

The Department of Revenue ("Department") issued Notices of Penalty Liability ("NPLs") to JOHN & JANE DOE ("respondents") pursuant to section 13 1/2 of the Retailers' Occupation Tax Act ("ROTA") and section 3-7 of the Uniform Penalty and Interest Act ("UPIA")<sup>1</sup>. The NPLs allege that the respondents were officers or employees of XYZ CORPORATION ("corporation") who were responsible for willfully failing to pay the corporation's retailers' occupation taxes ("ROT"). The respondents timely protested the NPLs. An evidentiary hearing was

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<sup>1</sup>. At the time that the first two NPLs, numbers XXXX and XXXX, were issued, the relevant provision was Ill.Rev.Stat. 1991, ch. 120, par. 452 1/2. At the time that the second two NPLs were issued, this section had been replaced by section 3-7 of the UPIA (35 ILCS 735/3-7).

held during which JOHN DOE ("JOHN DOE") testified and presented documentary evidence on behalf of the respondents. The Department presented testimony from a field collection manager. After reviewing the record, it is recommended that a portion of the liability be dismissed and the remaining amount be affirmed.

Findings of Fact:

1. The corporation began in July of 1989 for the purpose of operating a restaurant and bar. (Respondents' Ex. #1; Tr. pp. 10, 65).

2. From the corporation's inception until February 19, 1991, FICTITIOUS TAXPAYER was the president of the corporation. FICTITIOUS TAXPAYER was the vice-president and secretary from July of 1989 until September 27, 1990. (Respondents' Ex. #2, 3, 4, 7).

3. On September 28, 1990, JOHN DOE became a director of the corporation and received 10,001 shares of the corporation's stock. (Respondents' Ex. #4, 10; Tr. pp. 12, 16).

4. On February 20, 1991, JOHN DOE became the corporation's president and treasurer, and his wife, JANE DOE ("JANE DOE"), became the corporation's secretary. (Respondents' Ex. #8; Tr. pp. 10, 29).

5. In July of 1991, the corporation became insolvent and ceased operating. (Tr. pp. 30, 37-38).

6. JOHN DOE admitted that from the time that he became president until the corporation ceased operations, he was responsible for filing the ROT returns and paying the taxes to the Department on behalf of the corporation. (Tr. pp. 33-34).

7. From the time that he became president of the corporation until May of 1991, JOHN DOE remitted to the Department all of the ROT

that were collected. He testified that the ROT liability for June and July of 1991 was not paid at the time that it was due because the corporation was insolvent at that time. (Tr. p. 65).

8. On April 30, 1993, JOHN DOE paid \$4,370.39 to the Department from his personal account for ROT owed by the corporation for the time period from January through July of 1991. (Respondents' Ex. #30; Tr. pp. 43-44).

9. Sometime around the end of January or beginning of February in 1991, JOHN DOE became aware that the corporation's liquor license had been revoked as of January 30, 1991 due to the corporation's failure to pay its ROT liability for the months of December 1989, January 1990, and June through November of 1990. (Respondents' Ex. #11; Tr. pp. 21-23, 55-57).

10. Before the Department would recommend to the Liquor Control Commission that the corporation's license be reinstated, the Department required that the corporation either pay its past due ROT or enter into an installment contract for the payment of the past due ROT. (Tr. p. 110).

11. On February 26, 1991, the corporation, through JOHN DOE as president, entered into an installment contract with the Department to pay the corporation's delinquent ROT liability for the months prior to the time that JOHN DOE became president. JOHN DOE stated that he executed the installment agreement on behalf of the corporation so that the corporation could get its liquor license reinstated. (Dept. Ex. #3; Respondents' Ex. #15, 16; Tr. pp. 22-28).

12. The corporation made payments under the installment contract beginning with a downpayment of \$12,000 in February of 1991. The

corporation stopped making payments under the contract when the corporation became insolvent. (Respondents' Ex. #12, 21, 22, 23; Tr. pp. 30-33).

13. The respondents were signatories on the corporation's bank account at Magna Bank. (Respondents' Ex. #22, 23, 25, 26, 27, 28).

14. Between January 1991 and the date that the corporation ceased operations in July of 1991, JOHN DOE loaned over \$50,000 to the corporation. (Tr. p. 38).

15. The corporation's bank statements from Magna Bank for June, July and August of 1991 indicate that deposits totalling \$70,604.84 were made to the corporation's account during those months. (Respondents' Ex. #31, 32, 33; Tr. pp. 69-72).

16. On March 29, 1993, the Department issued NPL number XXXX to JOHN DOE and NPL number XXXX to JANE DOE. Each NPL proposed a total penalty liability of \$35,164.20, including tax, interest, and penalty, for failure to pay ROT for the following months: January, June, July, August, September and November of 1990, and June and July of 1991. The NPLs were admitted into evidence under the Director's Certificate. (Dept. Ex. #1).

17. On June 4, 1996, the Department issued NPL number XXXX to JOHN DOE and NPL number XXXX to JANE DOE. Each NPL proposed a total penalty liability of \$18,169.37, including tax, interest, and penalty, for failure to pay ROT for the months of November 1989 to July 1991. These NPLs were based on assessment number XXXXX, which was the result of an audit that was conducted after the corporation was insolvent. The NPLs were admitted into evidence under the Director's Certificate. The Department stated in its brief that it questions the extent to

which the respondents willfully failed to pay this liability. (Dept. Ex. #1; Dept. Memorandum p. 12).

Conclusions of Law:

Section 13 1/2 of the Retailers' Occupation Tax Act provides in part as follows:

"Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed in accordance with Section 3 of this Act and who wilfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon;" Ill.Rev.Stat. 1991, ch. 120, par. 452 1/2 (now 35 ILCS 735/3-7(a))<sup>2</sup>.

An officer or employee of a corporation may therefore be personally liable for the corporation's taxes if (1) the individual had the control, supervision or responsibility of filing the ROT returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

For guidance in determining whether a person is responsible under section 13 1/2, the Illinois Supreme Court has referred to cases interpreting section 6672 of the Internal Revenue Code (26 U.S.C.

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<sup>2</sup>. The following is the relevant part of section 3-7 of the UPIA: "Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who wilfully fails to file the return or make the payment to the Department or wilfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon." (35 ILCS 735/3-7(a)).

§6672).<sup>3</sup> See Branson v. Department of Revenue, 168 Ill.2d 247, 254-56 (1995); Department of Revenue v. Heartland Investments, Inc., 106 Ill.2d 19, 29-30 (1985). These cases state that the critical factor in determining responsibility is whether the person had significant control over the corporation's finances. See Purdy Co. of Illinois v. United States, 814 F.2d 1183, 1186 (7th Cir. 1987) Responsibility is generally found in high corporate officials who have control over the corporation's business affairs and who participate in decisions concerning the payment of creditors and the dispersal of funds. Monday v. United States, 421 F.2d 1210, 1214-1215 (7th Cir. 1970), cert. den. 400 U.S. 821.

In addition, these cases define "wilfull" as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious known risks. See Branson at 254-56; Heartland at 29-30. Wilfull conduct does not require bad purpose or intent to defraud the government. Branson at 255; Heartland at 30. Willfulness may be established by showing that the responsible person (1) clearly ought to have known that (2) there was a grave risk that the taxes were not being paid and (3) the person was in a position to find out for certain very easily. Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987). Furthermore, whether the person in question willfully failed to pay the taxes is an issue of fact to be determined on the basis of the evidence in each particular case. Heartland at

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<sup>3</sup>. This section imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes.

30; Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill.2d 568, 577 (1977).

Under section 13 1/2, the Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due. See Branson at 260.<sup>4</sup> Once the Department presents its *prima facie* case, the burden shifts to the respondent to establish that one or more of the elements of the penalty are lacking, i.e., that the person charged was not the responsible corporate officer or employee, or that the person's actions were not wilfull. Id. at 261. In order to overcome the Department's *prima facie* case, the allegedly responsible person must present more than his or her testimony denying the accuracy of the Department's assessment. A. R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826, 833-34 (1st Dist. 1988). The person must present evidence that is consistent, probable, and identified with the respondent's books and records to support the claim. Id.

In the present case, the Department's *prima facie* case was established when the Department's certified record relating to the penalty liability was admitted into evidence. In response, JOHN DOE admitted that he was a responsible corporate officer from the time

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<sup>4</sup>. The relevant portion of section 13 1/2 provides as follows: "The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be *prima facie* correct and shall be *prima facie* evidence of a penalty due under this Section. Proof of such determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. Such reproduced copy shall, without further proof, be admitted into evidence before the Department or any legal proceeding and shall be *prima facie* proof of the correctness of the penalty due, as shown thereon." Ill.Rev.Stat. 1989, ch. 120, par. 452 1/2.

that he became president until the corporation stopped its operations. JOHN DOE paid \$4,370.39 to the Department from his personal account in order to cover the ROT deficiency for the time period that he was president. Nevertheless, JOHN and JANE DOE contend that because they were neither officers nor employees of the corporation prior to February 20, 1991, they should not be responsible for the ROT liability that became due prior to February 20, 1991.

Even though they were not officers or employees when the liability was initially due, the respondents became responsible officers as of February 20, 1991. When they took over the corporation, they became responsible for handling all of the corporation's business affairs. Although JOHN DOE stated that he had been assured by the sellers that all of the corporation's pre-existing liabilities had been satisfied, JOHN DOE apparently did not investigate as to whether there was an outstanding liability owed to the Department prior becoming an officer. Once the respondents became officers of the corporation and took over the responsibility of paying the ROT, they became responsible officers under section 13 1/2.

Moreover, the respondents have not presented evidence showing that the failure to pay the ROT was not wilfull. Willfulness has been found when the responsible person knew of the tax delinquency and knowingly failed to rectify it when there were available funds to pay the government. Gephart v. U.S., 818 F.2d 469, 475 (6th Cir. 1987). Not only was JOHN DOE aware of the unpaid ROT liabilities for the time period prior to January 1991, as president of the corporation he entered into an agreement with the Department to pay the liabilities. In addition, substantial amounts of money were deposited into the



corporation's bank account, including a personal loan from JOHN DOE, during the time period that the respondents were officers. Nevertheless, the respondents did not make sure that the taxes owed to the Department were paid. Courts have found that giving preferential treatment to other creditors rather than paying the corporation's taxes constitutes wilfull behavior. See Heartland at 29-30. The respondents have therefore failed to overcome the Department's *prima facie* case.

Although the foregoing analysis warrants a recommendation that the NPLs be upheld, for the following reason, it is recommended that NPLs XXXX and XXXX be dismissed. In the Department's memorandum of law, the Department expressed concerns about holding the respondents liable on these NPLs. The Department noted in its brief that the audit that was the basis of these NPLs was not concluded until after the corporation ceased operating. The Department states as follows:

"Because neither JOHN or JANE DOE could have had knowledge of the liabilities assessed by audit, at a time when they had access to corporate level funds with which to pay this liability, the Department questions the extent to which they could have willfully failed to make payment of this amount." (Memorandum p. 12).

In its reply brief, the Department asserts that only NPLs XXXX and XXXX should be upheld. (Reply brief, p. 5).

Because the Department has expressed these concerns and has asked that only NPLs XXXX and XXXX be upheld, it would be improper to hold the respondents liable for NPLs XXXX and XXXX. By making these statements, the Department has effectively conceded that the respondents are not liable for the assessment that is the basis of NPLs XXXX and XXXX.

Recommendation

It is therefore recommended that the first two NPLs, No. XXXX and XXXX, be upheld. It is recommended that the remaining NPLs, No. XXXX and XXXX, be dismissed. It is further noted that the payment of \$4,370.39 should be applied to the respondents' balance due on NPLs No. XXXX and XXXX.

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Linda Olivero  
Administrative Law Judge

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